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SUBJECT: AMBASSADOR'S ASSESSMENT: PEACE AND PROSPERITY
IN SRI LANKA--WHERE ARE WE AND WHAT CAN WE DO ABOUT IT

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SUBJECT: Ambassador's Assessment: Peace and Prosperity
in Sri Lanka--Where are We And What Can We Do About It

1. (C) SUMMARY: This is the Ambassador's assessment of where things stand in Sri Lanka 90 days after the new government took office. The heady optimism on peace and prosperity which prevailed when Ranil Wickremasinghe took over in December 2001 has largely disappeared. Though Ranil lost the April 2004 election largely on economic grounds, the gains by extremist parties also showed a deep disillusionment with politics as usual in Sri Lanka. President Kumaratunga's desire for peace is not questioned, but her ability to run a peace process is. Efforts by the Sri Lankan military to use Tiger renegade Karuna against the LTTE have eroded already weak trust and have the potential to get out of hand. Behind all of Kumaratunga's actions is a desire to change the Constitution to allow her to continue in politics after her Presidential term. The government's economic policy is muddled. It says some of the right things about a market orientation, but shows no clear understanding of how to move forward. Still, the country remains committed to peace and there is great economic potential. We need to continue to push both sides to compromise for peace, while realizing that our influence on the Tigers is much less than on the Government. We also should continue our efforts on the peace process, which is much bigger than just the peace negotiations. Our interest here centers on showing that terrorism can be defeated, and that transcends any particular government. Sri Lankans have freely and fairly chosen their government. We need to work with the new government, just as we did with its predecessor. END SUMMARY

2. (C) The United Peoples Freedom Alliance (UPFA) government headed by President Chandrika Bandaranike Kumaratunga (CBK) -- comprised of the President's own Sri Lanka Freedom Party (SLFP), the Marxist and Sinhalese chauvinist Janatha Vimukthi Peramuna (JVP), and some smaller leftist parties -- has been in office for three months. This report is the Ambassador's analysis of where things stand at this point on the two key, and interlinked, issues for the United States--peace and prosperity.

What Happened?

3. (C) When I arrived in Colombo in August 2003, the situation seemed clear and relatively optimistic. Ranil Wickremasinghe's United National Party (UNP) had won a substantial majority in Parliamentary elections in Dec 2001 running on a peace platform. The resultant ceasefire with the Tamil Tigers and the peace negotiations had made some major breakthroughs, particularly the Tiger's acceptance of a united Sri Lanka, and the government's acceptance that the Tamil issue could only be settled through the establishment of a federal system. On the economic side, the UNP was committed to quick and drastic economic reform, as they attempted to do away with Sri Lanka's legacy of state domination of the economy. The economy was booming, with growth predicted at over six percent, the stock market up, and a palpable air of excitement in the economic sphere. CBK remained as President of the country, but Ranil seemed firmly in charge of government policy and administration. The LTTE had suspended the peace negotiations in April 2003, but a resumption was expected soon after the Tigers, in October 2003, delivered their proposal for an Interim Self Governing Authority (ISGA) in the areas they effectively control.

4. (C) This whole edifice came crashing down after CBK took over three Ministries (including the Defense Ministry) on Nov 3, 2003, beginning a protracted power struggle with Ranil which culminated in her alliance's electoral victory in April 2004. USAID-sponsored pre-election polls showed that Sri Lankans believed that Ranil was better able to handle the peace issue (though

not by a huge margin), but that they also believed CBK could better handle the economy, law and order, and corruption. The UNP ran a lackluster campaign, and suffered a stunning loss, declining from 109 seats to 82. In retrospect, it is clear that voters were not happy with the UNP's economic policies. In particular the prosperity of Colombo and its surrounding areas hid a lack of economic progress in the rural areas where most Sri Lankans live (the Western Province, which houses the capital city, represents close to 50 percent of all economic growth in Sri Lanka. No other province provides more than 10 percent).

15. (C) Even so, the President's victory was not overwhelming. In fact, her UPFA won 105 seats in the 225-member parliament, leaving her short of a majority. And within that number, her SLFP won 66 seats, while her junior partner, the Marxist/Nationalist JVP, took a stunning 39 places. The UPFA's election manifesto revealed built-in contradictions. It generally supported the peace process while promising to be tougher with the LTTE--but with some significant reservations by the JVP--but resorted to outright populist gimmicks on the economy, such as promising a 70 percent pay hike to all government servants and to solve unemployment by immediately hiring into the government 30,000 unemployed college graduates.

16. (C) The election revealed, in my view, deep-seated unease among many Sri Lankans about where their country was heading. Ranil was forcing the country to confront two long-cherished assumptions of the Sri Lankan polity: that Sri Lanka was a unitary state dominated by Sinhalese Buddhists, and that Sri Lankans were essentially guaranteed a job for life without regard to economic imperatives or market signals. The election campaign also showed the resurgence of a Sri Lankan xenophobic tendency, in attacks on foreign "domination" of the economy, foreign "sellout" to the Tigers, and foreign "attacks" on Buddhism.. The widespread disillusionment with the two mainstream parties was shown most clearly in the success of the extremist parties: the unprecedented showing by a new Buddhist monk political party, the Jathika Hela Urumaya (JHU), which won nine seats, the twenty-two seats won in the North and East by the Tamil National Alliance (TNA), a stalking horse for the Tigers, in a campaign marked by LTTE intimidation, and the 39 JVP seats.

Problems on Peace

17. (C) During the November 2003-April 2004 period, nothing happened on the peace negotiations, as Ranil argued that he could not conduct negotiations while CBK was Defense Minister. The situation was further complicated when the LTTE's eastern commander, Karuna, broke away from Prabhakaran's leadership in early March 2004. Since April the situation has deteriorated considerably. The issue is not CBK's desire for peace -- no one should doubt that she is personally dedicated to that end. But her micromanagement style, her lack of consistency, lack of both clear lines of responsibility within the government and a unified government position, and the JVP's disagreement with CBK's policy, have led to confusion and an uncertain future for the peace talks. The talks are currently stalled, with the two sides unable to agree on the agenda. The Tigers insist they will only discuss an interim administration, using their ISGA proposal as the basis for negotiations. CBK wants also to discuss final settlement issues, but the Tigers say they won't do that until an interim administration has been agreed upon and implemented.

18. (C) CBK has taken some good steps. Her 1994-95 negotiations with the Tigers were run without any type of staff setup. She has rectified that failing this time, proposing the establishment of a political-level National Peace Council and a strengthened Peace Secretariat. Her choice of widely respected former diplomat (Sri Lankan Ambassador to the US and later UN Under Secretary General) Jayantha Dhanapala, a serious thinker and respected administrator, was a good one. But she remains the only decision-maker on all substantive peace issues, and no one seems to have authority besides her. At the same time, various voices in the government issue conflicting statements of policy. Foreign Minister Kadirgamar--a hard-liner on the Tigers--is especially well-known for this. There is no inter-agency process which decides what policy is and enforces it. And in the meantime, the JVP trumpets its belief the government is too soft with the Tigers, and that the Norwegian facilitator role is unwanted. The net result is a lack of trust by the Tigers, who proclaim--with some justification--that they do not know what the GSL wants. In all fairness, the impasse cannot be blamed entirely on CBK and her government. CBK has, in fact, shown a

willingness to compromise on the interim administration/final settlement issue. The Tigers, by contrast, have been completely obstinate, showing no willingness to compromise. CBK also changes her own mind. At one point she told me that she had agreed to the Tiger demands to deal only with the interim administration, and then shortly afterwards she backtracked.

Complicating Factors - Karuna and the Constitution

9. (C) The Karuna affair has muddled things up even more. Karuna's move was, in substance, a good thing. It was evidence of what we had always anticipated (and hoped) the peace process would bring about: a yearning by the Tigers and ordinary Tamils for a return to a normal life and a resultant breakdown of the Tigers' monolithic structure. The substance was great, but the timing was terrible. Without demilitarization and normalization, the outcome was a military confrontation between Prabhakaran and Karuna--which Karuna lost. Karuna fled to Colombo in an apparent liaison with the Sri Lankan military. Small pro-Karuna elements continue to operate against the mainline LTTE in the East, and probably can continue for some time. This has alarmed the Tigers and sown even greater distrust. The government and the military have played this very poorly. Their contradictory--and patently untrue--claims about their relationship with Karuna have set back the prospect for negotiations while gaining them very little.

10. (C) It is not clear who is calling the shots on Karuna. It is noteworthy, however, that the President believes that a negotiation has a best chance of success when one side is clearly stronger than the other. She has told this to me personally, and also to the Norwegians. If she is trying to operationalize this concept by using Karuna to weaken the Tigers, she is playing a very dangerous game. The Tigers have made this clear in several public statements, warning of a "bloodbath" and a possible return to war if the GSL uses Karuna in this way. The murder of several LTTE members in the East on July 5 followed by that appears to be a retaliatory suicide bombing in Colombo as I finish this cable on July 7 underscore how dangerous and volatile the current situation has become.

11. (C) The issue of CBK's future and possible Constitutional change is also muddling things up. CBK is currently in her second term as President, which will expire in either 2005 or 2006. (There is an arcane legal argument about the length of her term which I will not attempt to describe here.) The crucial point is not the length of her term, but that under the present Constitution, she is limited to two terms. That means that her political career will end at the expiry of her current term. Theoretically she could run for Parliament and become Prime Minister, but she would not want to hold that office under a powerful Executive President. Her UPFA ran for office on a pledge to amend the Constitution to abolish the Executive Presidency and make the Prime Minister Head of Government. Amending the Constitution requires a two-thirds majority, but she does not even have a simple majority. A simple majority would allow her to try the (legally dubious) move of converting Parliament into a Constituent Assembly, circumventing the need for a two-thirds majority. The point here is not whether or how she will amend the Constitution, but that her fixation on that determines what she does on other issues--like peace and the economy.

12. (C) The opposition--essentially the UNP plus several small ethnic parties, has as its chief goals to keep CBK from attaining a majority and to block Constitutional change. This has led to attacks on her conduct of the Peace Process. The UNP says that it would support her if she ran a genuine peace process, but has described her actions as a "sham Peace Process," designed only to lure support from the Tamil National Alliance (a group of pro-LTTE parliamentarians) to give her a majority.

What is the Economic Policy?

13. (C) The situation with regard to economic policy is somewhat similar to that of the peace process. The SLFP, which had introduced a rigid socialism to Sri Lanka in the 1970's, had changed tack and during previous periods of rule had introduced free market reforms including high-profile privatizations. The differences on economic policy between the UNP and SLFP had seemingly become a matter of degree, not of substance. The SLFP's campaign rhetoric, however--pushed along by their JVP partners--took a retrograde note. It promised to halt planned privatizations of major State enterprises, to increase subsidies on essentials, as well as the budget-busting exercises mentioned earlier. It was not clear if the SLFP believed what it was saying, or just seeking a political

advantage. Since coming into power, the government has continued to talk both sides of the fence while doing little. The Government finally delivered its public statement of economic policy--required by the Constitution as well as a prerequisite for a resumption of IMF loans--only on July 1. Trapped by its own rhetoric, the government has held domestic petroleum prices steady while the international price has soared and has begun the process of hiring 27,000 unemployed graduates for "management trainee" jobs in the Government. The Government says it will make large State enterprises more efficient by instituting a "Strategic Enterprises Management Agency" to oversee them -- essentially one more layer in an already inefficient bureaucracy. And the end of the Multi-Fiber Agreement quota system will almost surely mean significant job losses in Sri Lanka's most important export sector - the apparel industry.

14. (C) When I meet with Ministers and other high officials responsible for economic policy, they are always reassuring. They say they are committed to a market economy, but that the UNP government's policies need some "adjustments." They say they will not privatize large state enterprises, but isolate them from political interference and make them run efficiently. Privately, they admit they cannot possibly fulfill all of their election promises without busting the country's budget. The new government has some valid points in its economic policy. It points out that growth has been largely concentrated in the Colombo area, and that poverty remains unacceptably high in the rural areas. It admits that the large budget deficit needs to be controlled. In some ways the UPFA government is simply acknowledging political reality which cannot be ignored: just as in the recent Indian election, a large part of the populace felt neglected by earlier policies. To try to push policies which the majority of the populace rejects will not work.

15. (C) The problem is that the solutions offered are either cliché or counter-productive. The budget deficit will be fixed by making revenue collection more efficient, they say, and the rural poor will be lifted out of poverty by erecting tariff barriers on food imports, leading to a strengthened agricultural sector, for example. Unfortunately, identifying the problem is not synonymous with offering a solution, something the Government's economic framework fails to do.

16. (C) What is missing in all of this is a sense that Sri Lanka not only needs international investment, but has to compete for it. With investors free to choose where to put their money, a situation with continued hassles for new investors, an uncertain economic policy framework and ambivalent (at best) statements on key reform issues is not going to attract them. Our continued refrain to all who will listen is that Sri Lanka needs to make investment easier than anywhere else. Our advice appears to fall largely on deaf ears.

Where's the Boss? Who's in Charge?

17. (C) In both the peace process and the economy, one of the key problems is an almost cavalier approach to management. All decisions are concentrated at the top, but sometimes the top cannot be found. In mid-June the President, without any public announcement, took off for her daughter's medical school graduation in London. She spent almost two weeks there, and then abruptly returned, again without any notice. Her brother, Industries and Investment Minister Anura Bandaranaike, was also in London for over two weeks. In his absence, all important investment decisions were on hold.

18. (C) The cavalier attitude towards peace is especially disturbing, and hard to fathom. It is only two and a half years ago that the ceasefire transformed Colombo from a fear-racked city with omnipresent security barricades to a relatively carefree environment. Yet Sri Lankans voted out the man who had brought them that peace, and installed someone with a history of failed peace initiatives leading to renewed war. And the government's dalliance with LTTE rebel Karuna has heightened the feeling that they are playing with fire, feeling that they are immune to being burned. Sri Lankans have a peculiar ability to forget the recent past, it seems, and to assume that the current situation will continue. Ranil recently said to me that although he did not like to say it, he thought the government would only come to its senses and negotiate with the LTTE after there was another bad incident. Today's suicide bombing might be that very incident.

Where's the Good News?

19. (C) As I look back on what I have written, it seems

unremittingly gloomy, perhaps overly so. It is easy to be that way here, especially as the high hopes to two years ago seem to be frittered away. But is this an accurate picture? Not entirely, and there is some good news:

PEACE -----

--There is widespread public support for peace and an aversion to a return to war as an instrument to solve the ethnic conflict. Sri Lankans largely accept that Tamils have legitimate grievances which need to be addressed and that this can only be done through some type of devolution of power, a federal system.

--The President herself is clearly dedicated to peace.

--The LTTE also seems to have no desire to turn to war, though the fairly quick dispatch of the renegade Karuna faction indicates a continued ability to conduct military operations in a lethal manner, and today's suicide bombing--which we assume was carried out by the LTTE--shows they are ready and willing to resume violence.

PROSPERITY -----

--The economic strengths of the country remain: a literate, trainable workforce; good infrastructure (though it could be better); a desire for foreign investment; access to the Indian market under the Indo-Sri Lanka FTA.

--The country retains a basic free-market orientation.

--A private sector which is energetic and enterprising.

What this likely means is a long period of just "muddling through." While few expect war to break out, progress in the peace negotiations is likely to be minimal. This means that reconstruction of conflict-affected areas will also be minimal. It also means that foreign investors' enthusiasm will be tempered by the fear of renewed conflict. Economic growth will be moderate, but never reach the level (8-10% per year) that would allow a breakthrough in reducing poverty.

What Can We (And Others) Do? -----

120. (C) Before we think about what we can, or should, do, we need to keep in mind what our interests and goals are here. Our chief goal is peace, to see the end of the Tamil Tiger terrorist movement. We have two reasons for that. The first is to prevent any possible cooperation between the Tigers and trans-national terrorist groups. The second, and linked goal, is to show to the world that a terrorist problem can be resolved through negotiations and a political process. Prosperity is intimately linked with this because lack of economic opportunity is one of the driving forces behind the Tamil insurgency, and because the promise of greater prosperity can be used to sell peace to those portions of a Sinhalese populace skeptical of Tamil demands. Those interests and goals remain whoever is in power in Sri Lanka.

121. (C) We have worked till now, in concert with other concerned countries, to put as much pressure as possible on both the Government and the LTTE to take meaningful concessions for peace. While I wish I could offer some imaginative breakthrough, I have to say that the basis of our strategy remains the same. We just have to keep pushing. Both the Tigers and the Government want the support of the international community. That last phrase raises another point. That much tossed-about cliché?the "international community" really has a meaning here. The concerned countries (a phrase I prefer to "donors," because this is not just about money and our influence here far outweighs our actual cash outlays) act with considerable solidarity here, and that has an impact. It is something we want to work assiduously to preserve. We need to keep pushing the message--as delivered after the Brussels Co-Chairs Meeting--that the attention and funding of the international community will not be available forever, that unless the two sides make some progress, they will lose out.

122. (C) There are two caveats we need to keep in mind, however. The first is that both the GSL and the Tigers are fighting for their vital interests and, indeed, for their survival. They value our opinion, they want our money--but they won't sell out their own existence to get it. The second is that in pushing the two sides to take steps for peace, our power is asymmetrical. We have considerable influence on the GSL, which wants many things from us, from trade to aid. We have much less influence on the Tigers. They seem relatively immune to economic inducements and willing to subordinate economic

issues to political ones. With regard to the Tigers, the US is the bad cop, the hammer. We not only (correctly) keep them on the FTO list, but we also avoid all political level contact. We have a dual message for the Tigers: that they will remain on the terrorism list and be treated as terrorists until they change their behavior, but that they will come off the list and be treated as legitimate political players if they change what they do. We have to make sure that they understand both parts of this. I am sure they understand the first part, but it remains unclear to me whether they understand the second part. I believe we should consider whether there would be some value in communicating this message in a more direct way. Whether that is feasible or not, we have to keep looking for ways to put pressure on the LTTE. Our continued support for the Sri Lankan military also sends an important message to the Tigers that will lessen the temptation to return to war.

123. (C) On the economic side, we will need to keep pushing the government to do the right things, to be faithful to their own statement that "the policy framework will be based on market friendly, export oriented strategies supported by a strong regulatory and legal framework." Certainly we have no problem with that. The Millennium Challenge Account process offers us a good opportunity to do this. And we will need to recognize the limitations of their own political space, and just how far they can go.

Peace Process More Than Just Negotiations

124. (C) We also have to keep in mind that the peace process is much bigger than the peace negotiations. The peace process goes on everyday: in demining activities, in efforts to build civil society involvement in peace, in reconstruction and rehabilitation, and in many other ways. Every day the process continues, every new fact that is created on the ground, gives people a bigger stake in peace and makes it less likely that the country will go back to war. Our efforts and the efforts of other donors are a part of this and need to be strengthened.

Can They Get Together?

125. (C) The last three times I have seen the President, she has said the same thing to me. "Isn't it strange," she says, "that the moderate parties in Parliament control 75 percent of the seats, and the extremist parties control twenty-five percent, and yet the extremist parties dictate what we all do. Shouldn't the moderate parties be able to work together"? This is an extraordinary statement, because she is saying that the UNP and the SLFP (the seventy-five percent) have much in common, and that the extremists include her own coalition ally, the JVP. The problem, of course, is that the personal agendas of the two leaders, CBK and Ranil, are completely at odds. She wants to change the Constitution to abolish the Executive Presidency so she can become Prime Minister and continue her political career. Ranil wants to both become Executive President and see the end of CBK's active political life. Several of my predecessors as Ambassador have told me of their fruitless attempts to convince Ranil and CBK to "put aside political differences and work together for the good of the country." None of them succeeded, and neither I nor anyone else would be more successful now. The one thing which might drive them together is the (not unrealistic) fear that the public could become so disgusted with the antics of both parties that they would turn to the JVP, which would swallow them up.

126. (C) And if I had to guess, I would venture that the most likely mid-term political scenario is that the JVP will mark its time and then, when it feels the opportune moment has come, pull out of the UPFA government. The SLFP and UNP will then have two choices: either to have another election with the prospect of strong JVP gains, or even a JVP victory, or to work with each other in some type of national unity government. That will lead to some interesting maneuvering if it ever comes to pass.

Where Do We Go From Here?

127. (C) This exercise has come out very like the classic three-option action memo. Deciding against both abject capitulation or a pre-emptive strike (options one and three), we will naturally decide to follow option two--the measured course which has served us so far. That is, indeed, where I end up. Basically, we just have to keep slogging away. Our actions within the bilateral context become even more important in the current political climate: it is easy to support the GSL when things are going well, but our continued efforts on all fronts, especially the AID/development one, will reinforce to all Sri Lankans that the USG remains committed in all the

little important ways even when no big strides are being made. We have to accept the political reality of today's Sri Lanka, that the Sri Lankan people have chosen the government they want, and that we have to work with that government. The great optimism of the early Ranil days is gone, and we will not get it back. But we can help Sri Lanka make progress on both peace and prosperity, and it is in our interests to do so. And finally, we have to remember that, since Sri Lanka is a genuine democracy, the people of Sri Lanka may change their mind again when next given the chance.

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